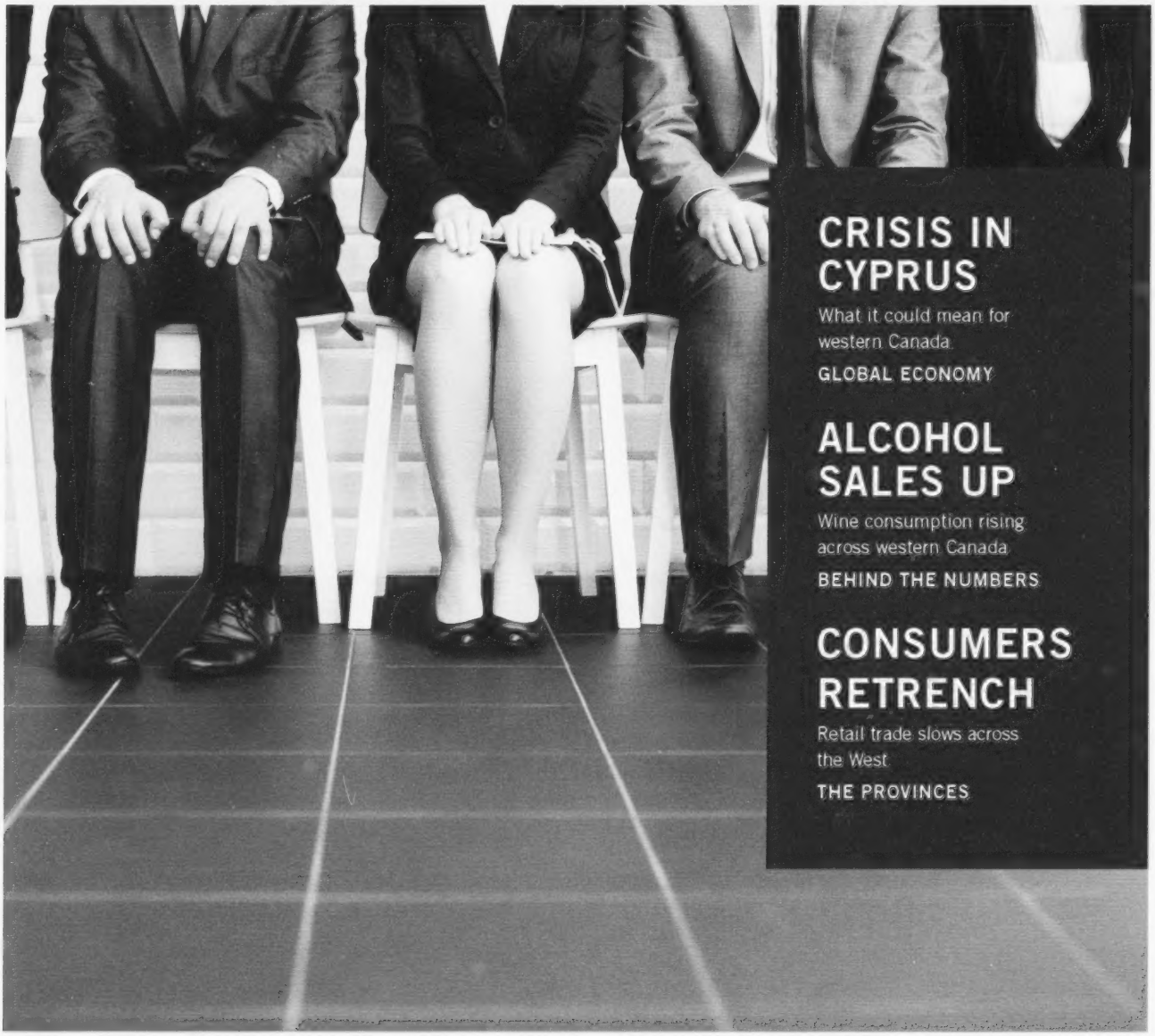
CURRENTS

WESTERN CANADA'S
ECONOMIC BULLETIN

FEATURE STORY

Equality of opportunity matters more than income inequality

CANADA WEST FOUNDATION MAY 2013



CRISIS IN CYPRUS

What it could mean for western Canada

GLOBAL ECONOMY

ALCOHOL SALES UP

Wine consumption rising across western Canada

BEHIND THE NUMBERS

CONSUMERS RETRENCH

Retail trade slows across the West

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GLOBAL ECONOMY

The European Catch-22

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MICHAEL HOLDEN, SENIOR ECONOMIST

Should Western Canada be worried about the latest Eurozone crisis?

The recent near-collapse of the banking system in Cyprus has brought the EU's economic and fiscal struggles back onto the front pages of economic news. For the moment, the impact of the Cypriot crisis appears to have been successfully contained to the small island economy and its banks' unfortunate deposit-holders. However, it serves as a grim reminder that even though the EU is in a more stable position today than it was two years ago, there is a long way to go before it turns the corner.

What's going on in the EU?

The banking crisis in Cyprus was essentially a delayed reaction to the restructuring of Greek debt last summer. Cypriot banks had bet heavily on Greek bonds and lost just as heavily. The problem was magnified by two factors: 1) as an offshore financial centre, the assets held by its banks were five-and-a-half times the size of the entire Cypriot economy; and, 2) the Cypriot government was yet another example of an EU member that repeatedly flaunted limitations on the size of deficit it could carry. By the time the banking system's struggles ballooned into a crisis, the banks were too large and the government too indebted to be able to afford to step in – thus the need for involvement by the IMF, EU and European Central Bank.

This crisis is the latest setback for the EU which has been struggling to get out of an economic and fiscal catch-22. There is a desperate need to bring government deficits around the EU back to more manageable levels. However, with the EU economy in recession, government revenues are weak and austerity measures are the only real option to improve fiscal balances. The problem is that reducing government spending during an economic downturn tends to make that recession worse.

What does this mean for Western Canada?

At first glance, neither the banking crisis in Cyprus nor the EU's general malaise is of much direct concern to western Canada. Cyprus accounts for just 0.2% of the EU economy and the EU is a relatively unimportant export market for the West. Only 3% of western Canada's exports last year went to EU countries and that share has been steadily declining for the past 20 years. By way of comparison, western Canadian exports to Asia are now six times higher than exports to the EU.

While the EU saga may be of little immediate consequence to western Canada, it would be a mistake to dismiss it entirely. Struggles aside, the EU is still the world's largest economy. In an interconnected world, the repercussions of a new crisis, or even prolonged stagnation in that region, will inevitably be felt around the globe.

The more benign of the two possible scenarios is sustained economic weakness in the EU into the near future. To the extent that the EU struggles, it will continue to be a drag on global economic growth and commodity prices, affecting western Canadian export opportunities as well as potential investment and project expansion in western Canada.

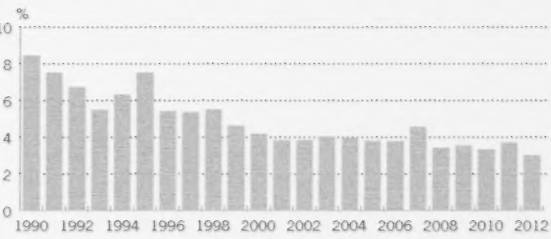
A worse outcome is that the Cypriot crisis might erode public confidence in the banking system elsewhere and become a domino in a cascading financial contagion. The risk of that taking place is not large, but the impact would be considerable. Western Canada has still not fully recovered from the last time a foreign banking crisis spilled over into the global economy. For the next few months, therefore, nervous eyes will be on the countries most at risk—EU nations like Portugal, Spain, Italy and some others—as well as Russia and other countries which were heavily exposed to Cypriot banks.

EURO AREA ECONOMIC GROWTH (% growth in real GDP)

	2008	2009	2010	2011	2012	2013f	2014f
Euro Area	0.4	-4.4	2.0	1.4	-0.6	-0.3	1.4
Germany	1.1	-5.1	4.2	3.0	0.7	0.5	2.0
France	-0.1	-3.1	1.7	1.7	0.0	0.1	1.2
Italy	-1.2	-5.5	1.7	0.4	-2.4	-1.0	0.8
Spain	0.9	-3.7	-0.3	0.4	-1.4	-1.4	0.8
Greece	-0.2	-3.1	-4.9	-7.1	-6.4	-4.4	0.6
Cyprus	3.6	-1.9	1.3	0.5	-2.4	-3.5	-1.3

Source: Eurostat. Notes: f = forecast. Data for Greece are provisional

WESTERN CANADIAN EXPORTS TO THE EU (% of total exports)



Source: Canada West Foundation calculations using Statistics Canada data

WESTERN COMMENTARY

Preserving Equality of Opportunity in Canada

This commentary is derived from testimony by Canada West Foundation Senior Economist Mike Holden at the House of Commons Standing Committee on Finance in April 2013. The Committee is studying the issue of income inequality in Canada.

Income inequality is a challenging subject. Most of us probably agree that too much inequality is a bad thing. It can lead to social exclusion, crime and political disengagement.

I submit, however, that equality of opportunity and poverty matter far more than equality of income. All Canadians deserve a fair chance to succeed. There are many policies areas where progress could improve equality of opportunity and keep income inequality from growing. I will highlight four.

First, we need to improve economic prospects for Aboriginal Canadians. This is especially important in the West, where two thirds of Canada's Aboriginal people live. The federal government needs to better foster economic development on Aboriginal reserves. It also needs to greatly enhance the quality of on-reserve K-12 education and it needs to improve Aboriginal skills training and labour force engagement.

Second, policies to address income inequality must not impede labour mobility. In fact, the federal government needs to do better than just removing barriers. It needs to *encourage* mobility across the country.

There is a desperate need for workers in the West, where industry-specific labour shortages are limiting growth. Meanwhile, there is surplus labour capacity in other provinces. It does not make economic sense to spend money on policies and programs to kick-start economic development in struggling regions when doing so prevents other parts of the country from growing at their full potential.

Third, we need a strong focus on education and skills training.

The federal government took steps to address skills training in its most recent budget. Time will tell how effective those new initiatives will be, but the government deserves credit for trying to improve the existing system.

On the education side, however, there is an ongoing mismatch between the skills that students are developing and those in demand by employers. The stubborn social bias favouring universities over technical schools and skilled trades programs also has to end. Perhaps above all, rising tuition costs cannot become a barrier to entry for poorer students. If that happens, then equality of opportunity evaporates.

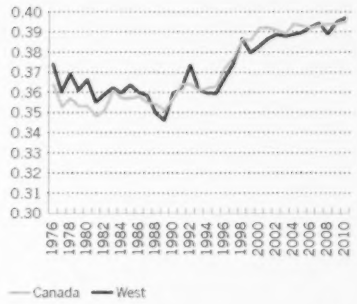
Finally, there is the issue of taxes. Canada's progressive tax system already helps to smooth out income inequality. Could it do more? Probably. But we need to tread carefully on tax policy. Government revenues already depend heavily on the contributions of the rich. The wealthiest 10% collect 35% of total income, but pay 55% of federal and provincial income taxes.

These Canadians are also the most mobile. We can very quickly improve income inequality by driving the rich out of the country, but tax revenues would evaporate, taking away our capacity to implement programs and policies to help the poor.

This is not to say that increasing taxes on the richest Canadians should be completely off-limits. But it would be more useful to focus on measures to help lower income earners rather than on penalizing the rich.

INCOME INEQUALITY AND TAXES PAID BY THE WEALTHY

INCOME INEQUALITY IN CANADA
(Gini coefficient)

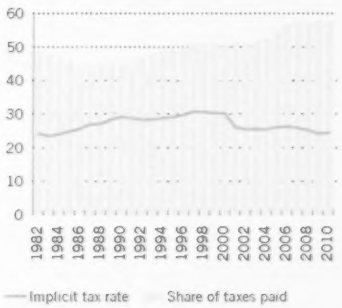


Source: Canada West Foundation calculations using data from Statistics Canada

Notes: The Gini coefficient is a measure of inequality where a score of 0 is perfect equality and a score of 1 is perfect inequality

Data on inequality in western Canada is estimated by the Canada West Foundation

TAX CONTRIBUTION OF THE RICHEST 10% IN THE WEST (%)



Source: Canada West Foundation estimates using data from Statistics Canada

BRITISH COLUMBIA

Struggles continue for the BC economy

BC continues to be the weak economic link in western Canada. Most indicators point to flat or declining economic activity, suggesting that BC may end up with the slowest growth of the four western provinces in 2013.

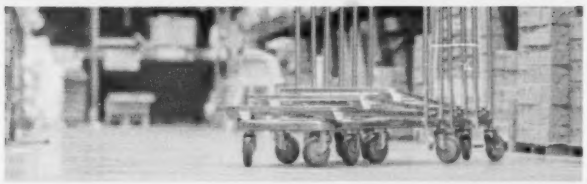
Labour markets in BC hit a setback in March as the province lost 14,800 jobs that month, essentially wiping out all the gains made in February. Job losses were concentrated in construction and education services. As a result, the provincial unemployment rate jumped from 6.3% to 7.0% in March.

Echoing a trend seen across Canada, retail sales activity has ground to a halt in BC as slower economic growth, rising consumer debt levels and housing market uncertainty keep shoppers at home. Retail sales slowed dramatically through 2012 and on a year-over-year basis, have fallen for four months in a row (October through January). This momentum is likely to continue as preliminary data suggest that new motor vehicle sales in February are down 4.1% compared to last year.

Businesses also expect to spend less money on new facilities and equipment in 2013, contributing to a more pessimistic outlook for the province. Private capital investment intentions in BC are down slightly from 2012 levels, led by a steep drop-off in natural gas and mining investment. In its recent Speech from the Throne, the BC government was optimistic that natural gas developments would spur future economic growth in the province. While this may yet be the case, the industry is getting off to a slow start as low gas prices are contributing to poor investment conditions in that industry.

The BC housing market remains relatively weak, but evidence is pointing to the best possible outcome: a soft landing in which prices moderate over time, leading to a gradual improvement in home affordability. For the province as a whole, resale prices in March were off about 12.7% from peak levels, but have been largely flat since last May. The Vancouver, Victoria, Okanagan and Kootenay regions are showing the steepest declines.

However, there may be more downward movement in housing prices yet to come. New listings in BC are flat, but the number of sales has been decreasing more or less steadily since 2011. This combination suggests a buildup in the inventory of unsold houses, which could push prices lower in the near future. In particular, the unabsorbed inventory of homes in Vancouver in February was nearly 57% higher than a year earlier. That inventory will have to return to more sustainable levels before prices can be expected to stabilize.



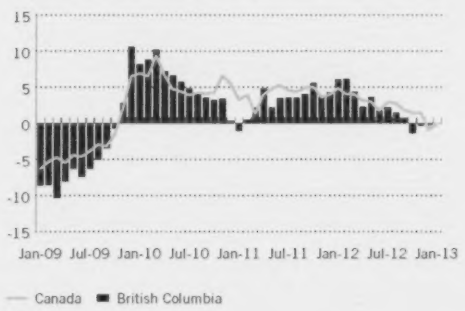
The BC economy has lost

25,700

jobs since September 2012.

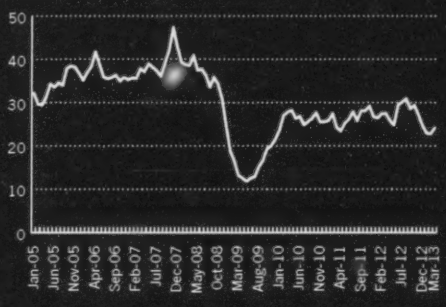
Source: Statistics Canada

RETAIL TRADE GROWTH (year-over-year % change)



Source: Canada West Foundation calculations using Statistics Canada data

BC HOUSING STARTS (000s of units)



Source: Canada West Foundation calculations using Statistics Canada data
Note: Data coverted to 3-month moving average

ALBERTA

Some weak spots amid general strength

Employment fell sharply in March as the Alberta economy shed 11,300 jobs, the largest single-month decrease in more than three years. These losses, which occurred mostly in part-time positions, drove the provincial unemployment rate up to 4.8% in March – its highest level since last April. Job losses were spread across a range of industries, notably retail trade, accommodation and food services, finance and insurance, and utilities. It remains to be seen whether this is a one-month aberration or the beginning of a more serious downturn in economic fortunes.

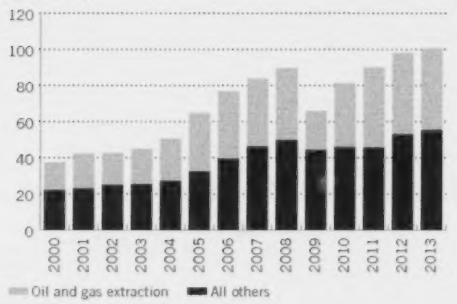
The construction industry was also among those hit with job losses in March. However, construction employment should pick up in the months ahead. In what is normally a quiet month, the province issued $1.2 billion in new building permits in February – close to 60% higher than a year ago. While the outlook is for slower residential construction, non-residential activity is expected to be strong in both Calgary and Edmonton.

After a period of stagnation in 2011 and early in 2012, the housing market in Alberta appears to be taking off once again. Resale volumes in the province are rising, while the number of new listings coming on line has been flat. This combination is putting pressure on housing prices. Average resale prices rose by 6.2% from October to March, twice the national average rate. Rising prices may also trigger an increase in new housing starts which have been flat since July and remain well below pre-recession levels.

Investment activity in Alberta is poised for another strong year. Capital expenditures for 2013 are expected to reach a record $101 billion, up 2.4% over last year's levels. For the second year in a row, the increase will come almost entirely outside of the oil and gas sector, where capital spending has been flat since 2011. Even so, oil and gas activity continues to be a magnet for investment in the province; it is expected to account for 45% of capital expenditures in Alberta in 2013 and 11.4% of expenditures nation-wide.

Reflecting a trend seen in most provinces, Alberta's exporters are, on the whole, having a quiet year so far in 2013. Through February, exports are up just 1.3%. Sales of oil, by far the province's largest export, are flat as production volumes and prices are showing little recent movement. Exports of natural gas and wheat are both significantly higher, while shipments of canola seeds and propane are down to start the year.

CAPITAL EXPENDITURES – ACTUAL & INTENTIONS
($ billions)

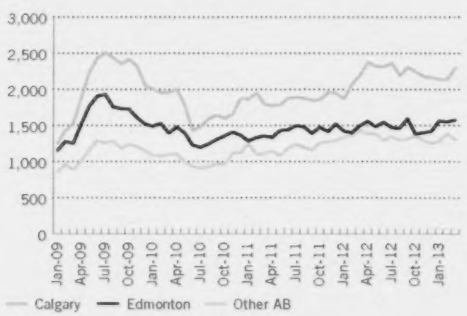


Source: Canada West Foundation calculations using Statistics Canada data

25%
of all capital spending across Canada takes place in Alberta.

Source: Statistics Canada

MONTHLY HOUSING SALES (Number of units)



Source: Canadian Real Estate Association

SASKATCHEWAN

Labour market pressures rise

While national labour markets dipped in March, Saskatchewan continued to churn out new jobs at a frenetic pace. In the first three months of 2013, employment in the province was 4.4% higher than the same quarter last year, by far the fastest rate of growth in the country. The province has created 25,000 new jobs over the past 12 months, driving the unemployment rate down to 3.9% in March.

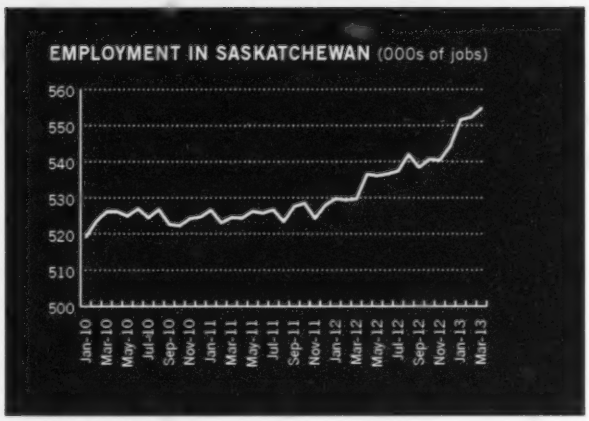
This torrid pace of job creation is fuelling concerns about labour shortages in Saskatchewan. At the end of 2012, there were an estimated 12,400 unfilled job vacancies in the province, compared to 23,200 unemployed residents. The unemployment-to-job vacancies ratio of 1.9 is the lowest in Canada – evidence not only of tight labour markets in the province, but also of a potential mismatch between existing skills and those in demand.

In spite of tight labour markets, wage pressures in Saskatchewan have begun to ease off. The province has seen extraordinary wage growth in recent years, propelling average weekly earnings above the national average for the first time in mid-2011. However, weekly earnings in Saskatchewan have been flat since last July.

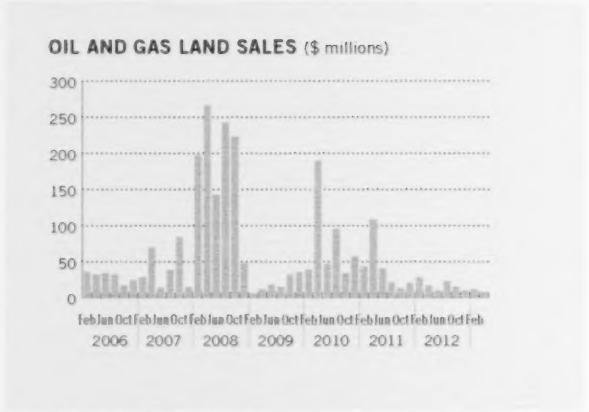
Crude oil production in Saskatchewan was solid to close out 2012, but new exploration and development activity is slowing. Oil and gas land sales through April have yielded a disappointing $19.6 million in revenues for the provincial government in 2013, less than half the amount raised over the same period last year. Land sales in April were the lowest in over a decade.

The province's uranium industry received a boost in early April when the Canadian Nuclear Safety Commission finalized an agreement that would allow Saskatchewan uranium to be exported to India, a market that had hitherto been barred to Canadian exporters. Access to India represents a potentially huge development for uranium producers. India is not only a major user of nuclear power today, but its uranium consumption is expected to more than triple over the next ten years as several new power plants are scheduled to come on line by 2021.

This deal, combined with the recent agreement to supply 1.1 million tonnes of potash to Indian customers should mean a big year for exports to India in 2013. Exports through February are already triple last year's levels, largely because of a surge in shipments of pulse crops. In total, exports from Saskatchewan have grown by 7.7% through February. This pace is among the fastest in Canada, but considerably slower than in 2011 and the first half of 2012.



Source: Statistics Canada



Source: Government of Saskatchewan

Planned capital spending in Saskatchewan on oil and gas extraction has fallen

34%

since 2011.

Source: Government of Saskatchewan

MANITOBA

Capital investment to keep the province moving

Economic prospects in Manitoba are slowing as the province struggles with the same consumer-led slowdown affecting most of Canada. After modest growth through much of 2012, retail trade in Manitoba began to fall toward the end of the year. January's retail trade figures were 1.2% lower compared to the same month last year.

Labour market activity has been flat through the first quarter of the year after a strong run through most of 2012. The number of jobs in the province is essentially unchanged since December. However, underlying conditions are somewhat worrying. The province has lost 4,800 full-time jobs so far in 2013. Overall employment levels are flat because those jobs were replaced by part-time positions.

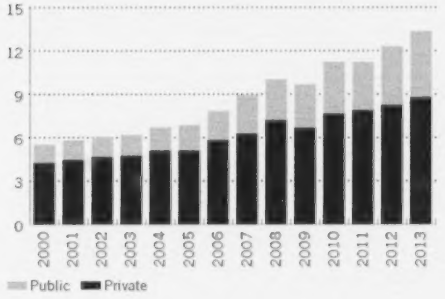
By contrast, the outlook for construction in Manitoba remains buoyant. Public and private investment intentions in the province are up strongly in 2013 and could push capital expenditures to record levels this year. Private capital spending is expected to be 6.3% higher than in 2012, while public investment will be close to 13% higher. Utilities and resource-extracting industries account for most of the increase in planned outlays.

Manufacturing output has slipped across Canada since last summer, including in Manitoba. However, manufacturing shipments from the province rose sharply in February for the second consecutive month. While the surge was only enough to offset recent losses, it may be the first sign of a long-awaited recovery in the sector, especially considering expectations that US demand will pick up speed as the year wears on.

A strong economic recovery in the US would also be welcome news for Manitoba's exporters. No province in western Canada depends more heavily on the US market than Manitoba for non-energy goods. After the 2008 recession, Manitoba's exports to the US fell sharply and a high exchange rate and poor market conditions have prevented a speedy recovery. In 2012, US-bound exports remained nearly 17% below peak levels. This poor sales record has been a drag on the Manitoba economy. Even through the first two months of 2013, exports are up only slightly compared to last year.

However, there is reason for optimism. In the absence of growth in trade with the US, Manitoba businesses have been making significant inroads into alternative markets, especially China. Exports to China are six times higher than they were a decade ago and continue to expand rapidly. A recovery in shipments to the US could complement this expansion in China and help Manitoba's manufacturers and exporters pick up the slack in the Manitoba economy left by consumers.

CAPITAL EXPENDITURES – ACTUAL & INTENTIONS
($ billions)



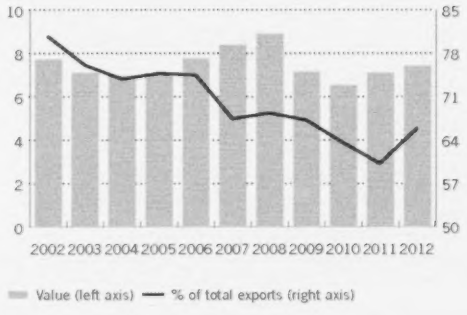
Source: Statistics Canada

62.4%

of Manitoba's non-energy exports go the US – the highest proportion in the West.

Source: Statistics Canada

MANITOBA EXPORTS TO THE US ($ billions)



Source: Canada West Foundation calculations using Statistics Canada data

BEHIND THE NUMBERS

Western Canadians spent record amounts on alcoholic beverages in 2012, thanks in large part to the growing popularity of wine.

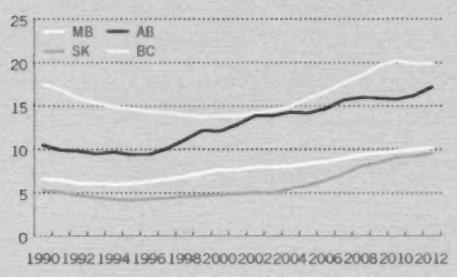
On average, each western Canadian spent $729 in wineries, liquor stores and other retail outlets in 2012, an increase of 32% over the past decade.[1] In all four provinces, alcohol sales are being driven by steadily-increasing sales of wine. The average western Canadian consumed 16.5 litres of wine in 2012 compared to 12.4 litres a decade earlier.

BC and Alberta are two of the largest per capita wine consumers in Canada, behind only Quebec. On average, each British Columbian bought 19.9 litres of wine in 2012 while each Albertan purchased 17.2 litres. Although growing quickly, wine consumption in Manitoba and Saskatchewan is significantly lower.

Home to a vibrant domestic wine industry, BC also has a taste for Canadian vintages. Nearly 58% of all wine bought in BC was of Canadian origin. Residents of Saskatchewan also prefer Canadian wines. By contrast, most wine purchased in Manitoba and Alberta was from abroad.

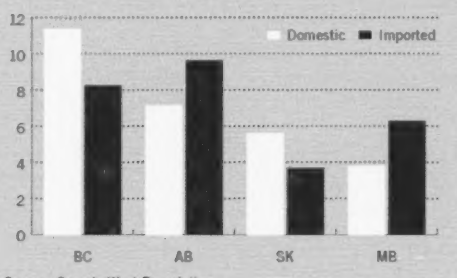
[1] Statistics Canada calculates per capita alcohol sales in reference to the Canadian population that is 15 years of age and older. That convention has been maintained in this analysis.

WINE SALES BY PROVINCE
(Litres per person)



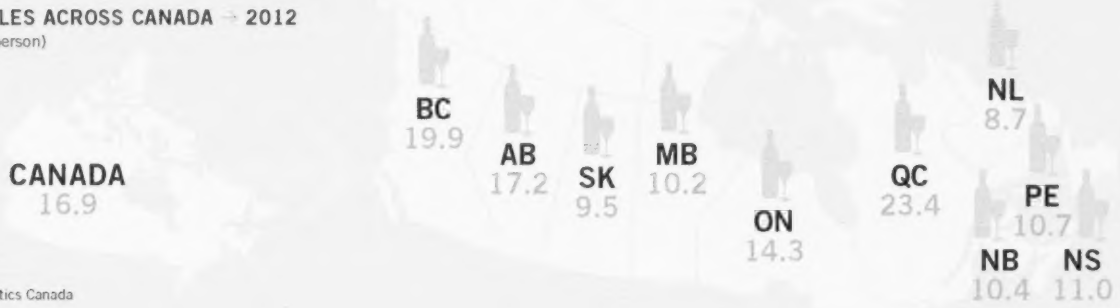
Source: Statistics Canada

DOMESTIC AND IMPORTED WINE CONSUMPTION – 2012
(Litres per person)



Source: Canada West Foundation

WINE SALES ACROSS CANADA – 2012
(Litres per person)



Source: Statistics Canada

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